



STATE BOARD OF LAND COMMISSIONERS

Dirk Kempthorne, Governor and President of the Board
Ben Ysursa, Secretary of State
Lawrence G. Wasden, Attorney General
Keith L. Johnson, State Controller
Marilyn Howard, Superintendent of Public Instruction

Winston A Wiggins, Secretary to the Board

Final Minutes Regular Land Board Meeting February 11, 2003

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, February 11, 2003 in Boise, Idaho. The meeting began at 9:05 a.m. The Honorable Dirk Kempthorne presided. The following members were present:

Honorable Secretary of State Ben Ysursa
Honorable Attorney General Lawrence G. Wasden
Honorable State Controller Keith L. Johnson

Secretary to the Board Winston A Wiggins

The Honorable Superintendent of Public Instruction, Dr. Marilyn Howard, was absent from this meeting.

Before beginning the meeting, Governor Kempthorne called upon Secretary of State Ysursa for an introduction.

Secretary of State Ysursa introduced Bob Brown, Secretary of State, State of Montana. Secretary Ysursa stated that he and Secretary Brown have had prior discussions about the Idaho Timber Stabilization Act. Montana has five million acres of endowment land and faces the same problems Idaho faces in trying to generate income from those lands. Montana recently put forward an endowment reform package. However, the reform package did not receive voter approval.

Audience with the Board

Bob Brown, Secretary of State for the State of Montana, was granted an audience with the Board.

Secretary of State Brown. Secretary of State Brown stated that the Montana system is almost identical to Idaho's system. The Montana and Idaho Boards of Examiners and Land Boards have the same membership. In reading the Idaho newspaper, Secretary Brown stated even budget figures and issues are similar. He added that the states are also alike in that both states have a federal land grant to manage and both states are trying to do so to the highest benefit of the school children.

One difference Montana noticed is that Idaho allows a more diversified investment of its Endowment Fund. Secretary Brown stated he was an advocate of diversification when the endowment reform package was presented to the voters in his state. The reform package was placed on the 2002 ballot, but the package was defeated. Idaho's endowment reform was placed on the ballot in 1998 and, as a consequence, Idaho's package passed when the bulls were surging, but Montana's was defeated when the bears were surging. As a result, Montana continues to manage its trust the same way Idaho formerly managed its trust. Idaho harvests somewhere over 200 million board feet of timber from the roughly 900 million acres of trust land managed for timber. Montana

harvests around 40 million board feet of timber on about 700,000 acres. Montana's timberland is not as productive as Idaho's, but it is still a dramatic difference. Montana is examining that difference now to see if a better job can be done to obtain more value from its timber resource.

Governor Kempthorne thanked Secretary of State Brown for visiting Idaho. He asked Secretary Brown what has been happening with Montana's endowment funds since it has not gone with the equity market. Secretary Brown stated in 1972 the Teachers' Retirement funds were invested partly in equities. Before then, the funds were invested in bonds, along with the School Trust moneys. The Fund held approximately \$72 million in the Teachers' Retirement Fund and approximately \$75 million in the Education Trust Fund. The Teachers' Retirement Fund, partly invested in equities in 1972, is now at \$2 billion. That dollar figure includes what has happened in the bear market for the last two or three years. The Educational Trust, which has always been invested in bonds, is somewhere around \$650 million. It is a dramatic difference. Secretary Brown commented even though the people in Idaho may think there has been a decline in the value of the trust, ten to fifteen years from now the change to a diversified portfolio will prove to be a wise decision. Secretary Brown believes the evidence shows that the Idaho Land Board took the correct action in 1998. Studies indicate that over most periods of time equities outperform bonds.

Governor Kempthorne commented that when the Idaho Public Employees Retirement System first began to enter equities, the market was good. However, by the time the State actually got into equities, the market took a dive. Had the Montana endowment reform package passed, the timing would have been good. Secretary Brown stated that argument was waged in his state, but the package did not succeed. Governor Kempthorne added it would even have been helpful if the State of Montana had been given some future trigger point. Secretary Brown agreed.

Governor Kempthorne wished Secretary Brown well and thanked the State of Montana for being a fine neighbor.

ITEM NOT ON THE AGENDA

Governor Kempthorne brought Senate Bill 1022 to the Land Board meeting and signed the bill in the presence of the meeting attendees.

Governor Kempthorne. As you recall, on February 12 of last year we declared a zone of infestation for the tussock moth in Latah and Benewah counties. The purpose of the declaration was to treat areas not previously treated in 2001. Subsequently, the Idaho Department of Lands sprayed a total of 30,000 acres, of which 20,000 acres were industrial landowners, over 4,000 acres were state endowment lands, 3,800 acres were non-industrial private landowners and 150 acres were owned by the Coeur d'Alene tribe. We sprayed for eight days. The total cost was \$1,245,000. Private landowners paid 12½% of the cost, a U. S. Forest Service grant paid 48% of the cost, and the general fund financed 39% of the cost, which was \$485,000.

Ladd Livingston was our lead project manager and technical expert. Jim Nichols was the incident commander in charge of the actual operation. The incident command team included over 35 individuals from the Idaho Department of Lands, the U. S. Forest Service and the Clearwater-Potlatch Timber Protective Association. The treatment successfully killed the tussock moth. Idaho Department of Lands does not anticipate another outbreak for several years. This operation is a good example of where we immediately jumped on a problem.

One of the concerns at Red Fish Lake is the mountain pine beetle. This beetle is decimating timber in that area, and there is concern that it will look like a clearcut.

With that, Governor Kempthorne signed Senate Bill 1022. In doing so, Governor Kempthorne asked that the pens used for signing Senate Bill 1022 be given to Ladd Livingston and Jim Nichols with appreciation for a job well done.

- **CONSENT AGENDA**

Director Wiggins provided background information on the Consent Agenda items.

A motion was made by Attorney General Wasden to approve the Consent Agenda in its entirety. State Controller Johnson seconded the motion. The motion carried on a vote of 4-0, with Superintendent Howard being absent for this vote.

1. Director's Report – Approved

- A. Interest Rate on Department Transactions – February 2003
- B. Bureau of Surface and Mineral Resources, Minerals Section, Official Transactions – January 2003
- C. Bureau of Real Estate, Land Sale Section, Official Transactions – January 2003
- D. Bureau of Real Estate, Easement Section, Official Transactions – January 2003
- E. Bureau of Surface and Mineral Resources, Range Management and Surface Leasing Section, Official Transactions – January 2003
- F. Timber Sale Official Transactions – December 21, 2002 through January 29, 2003
- G. Timber Sale Activity Report

2. Timber Sales – Staffed by Bob Helmer, Chief, Bureau of Forest Management – Approved

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|------------------------|-----------|-----------|
| A. West Petri | CR-4-0722 | 3,140 MBF |
| B. South Duffy | CR-4-0752 | 1,285 MBF |
| C. South Shanghai Pole | CR-4-0753 | 97,175 LF |
| D. Whiskey Buck | CR-4-0755 | 3,455 MBF |

3. Request for Approval to Advertise Public Hearing and Complete the Surplus Property Transfer for the Idaho Military Division in Gooding – Staffed by Perry Whittaker, Chief, Bureau of Real Estate – Approved

DEPARTMENT RECOMMENDATION: That the Board direct the Department to advertise a public hearing regarding transfer of the 1.48-acre parcel to the City of Gooding. Also, direct the Department to transfer the property to the City of Gooding in the absence of adverse comments at the public hearing.

BOARD ACTION: Approved.

4. Request for Conceptual Approval to Use Land Bank Funds to Purchase Private Land – Staffed by Susan Robbins, Real Estate Specialist – Approved

DEPARTMENT RECOMMENDATION: That the Board conceptually approve this purchase proposal and direct the Department to proceed with the appraisals.

DISCUSSION: Secretary Ysursa asked about the source of the funds currently in the Land Bank. Perry Whittaker, Chief, Bureau of Real Estate, commented that the majority of the balance in the Land Bank stems from a bonus payment associated with the Bannock 800 Land Exchange. Director Wiggins stated the only property the Department has sold at auction has been railroad right-of-way. Those moneys are in the Fund but are not currently up against the two-year timeframe.

Attorney General Wasden asked if the Snook parcel gives the state access to state lands. Director Wiggins stated if the Department can obtain the Snook parcel, then it can finish the other right-of-way agreements, which will give the state solid access from the county road to the state land.

BOARD ACTION: Approved.

5. Grazing Lease Auction Results – Presented by Tracy Behrens, Range Management Specialist – Approved

DEPARTMENT RECOMMENDATION: That the Board accept the high bid of \$370.00 submitted by Parrish Brothers LLP for lease G-9270 and the high bid of \$2,501.00 submitted by Mr. Hudman for lease G-8226 and direct the Department to issue new ten-year leases to the high bidders. Each lease will include a summary of the grazing management proposal submitted by the high bidder and accepted by the Department.

BOARD ACTION: Approved.

6. Minutes – Approved

A. Regular Land Board Meeting – January 14, 2003

• **REGULAR AGENDA**

7. Endowment Fund Investment Board Manager's Report – Presented by Matthew Haertzen, CFA, Manager of Investments

Dr. Nick Hallett, Chairman, Endowment Fund Investment Board opened the discussion. Dr. Hallett formally welcomed Matt Haertzen. He stated the Endowment Fund Investment Board is looking forward to trimming some expenses, and he recognizes at this time it is important to do that. Dr. Hallett stated the EFIB intends to reduce the scope of its consultant contract. A Request for Proposal will be released soon, and the EFIB feels with the new manager on board, they are in a good position to take that action. With that, Dr. Hallett turned the discussion over to Matt Haertzen.

Mr. Haertzen. Mr. Haertzen outlined the current structure of the equity portfolio. The structure was discussed in depth with the EFIB in January. Significant overweights were noted in portions of the portfolio. Relative to the benchmark, the portfolio is overweighted in large cap and is especially overweighted in small cap, with a special emphasis in small cap value. This weighting has actually paid off over the last couple of years. Small cap value has been one of the best performing asset classes from an equity perspective. In going forward, the Fund will become more benchmark-like in its overall structure. While the market cannot be predicted, the EFIB can focus on adding value through careful selection of active managers in the small-, mid-cap and international asset classes. Over the next several months, a number of changes will be made. The process for finding a mid-cap growth and mid-cap value manager has already started. Currently the portfolio does not have mid-cap exposure on the domestic equity side. By equally weighting the value and growth allocation in the portfolio, the EFIB hopes to smooth out some of the volatility. The Fund will end up exactly at the same point in the long run, but hopefully the interim volatility will be smoothed out.

From an equity perspective, it has been a difficult year so far. The equity market is down about 5½% year-to-date. On a relative basis, the portfolio is performing well. It is down about 3.1% versus 3.7% for the benchmark. The Fund is outperforming modestly relative to the benchmark. EFIB staff is in the process of interviewing every manager in the portfolio. The remainder of the managers should be interviewed by the end of next week. Changes are anticipated in terms of manager replacements.

Another matter for discussion is the cash flow issue. The bad news is it does not look any better. The Fund will still run a significant deficit by July. Secretary Ysursa asked if a change in statute is being

considered regarding the cash flow and timing. Mr. Haertzen stated in its projections, the EFIB is hoping that the equity markets help to recover some of the anticipated deficit. However, it becomes a bigger issue in each subsequent year because the Fund counts on some of the September, October and November money to help with the February 2004 payment. If it is acceptable to the sub-committee, Mr. Haertzen believes the Fund can continue through this summer if payments are delayed. However, the issue needs to be addressed for the long term.

Following up on Secretary Ysursa's question, Governor Kempthorne asked if any action needs to be taken. Mr. Haertzen stated he is waiting for specific permission from the sub-committee to delay those payments. Controller Johnson commented he has had some conversations with Dr. Howard's office, but those conversations have been limited. He stated he is not aware of any legislation proposed at this time to make a change in the statute. The sub-committee needs to convene to discuss the issue.

Audience with the Board

- **2002 Audit Presentation – Presented by Lou Henry, Audit Director, Deloitte & Touche**

Governor Kempthorne welcomed Mr. Lou Henry to the meeting. He recommended that the auditor come before the Land Board annually to present the completed audit report. The auditor's presentation will allow the Land Board to hear the information firsthand and to ask questions. Governor Kempthorne also recommended that the Land Board meet with the Endowment Fund Investment Board at least twice each year, if not quarterly. Interaction between the two boards will enhance communication and will keep all matters in the open.

Mr. Henry. Mr. Henry thanked the Land Board for the opportunity to present the audit report information. The report was presented to the Endowment Fund Investment Board in November 2002.

This year's audit report was delayed due to IDL and Endowment Fund receipts reconciliation. At year-end, when all of the agencies convert from cash to accrual, there is a significant amount of work that has to take place. The activity includes a reconciling process between IDL and the Endowment accountant to make sure money transferred from Lands makes it to Endowment and that both agree. At year-end, there are items in transit. Any adjustments during the year on one side may not show up on the other side so there were several items that caused the reconciliation process not to go smoothly.

Since the audit was initiated from the Endowment side of the equation, it was like a person given a jigsaw puzzle to put together without all of the pieces. It was almost impossible for the accountant at the Endowment Board to accomplish that task. We worked on this issue over the past two years as a special project because the audit itself would benefit from that process. We worked with the IDL accountants, the State Controller's office and the Treasurer because it was a round robin of where the money and accounting goes. The money and accounting did not always follow each other exactly, especially at year-end when cutoff procedures are taking place. At this point, most of those bugs are worked out. I do not anticipate this problem occurring again. The accountant working on special reconciliations for STARS, Merideth Hackney, was extremely helpful this year. We have a road map laid out so next year's reconciliation should go smoothly. However, the process has to be initiated at the accounting level at the Department of Lands and not at the Endowment because IDL has everything flowing. Endowment only gets pieces of the money because Lands sends money to other places as well. Although this is a long story, it involves a significant action that has created problems over the last two years. Everyone has been helpful in working through those problems. The four groups involved – the Treasurer's Office, the Controller's Office, IDL and the Endowment Fund staff – now understand their respective roles and needs. More work needs to be done, but both the accountant at Lands and the accountant at Endowment know where the pieces come from and who to ask. They are now preparing monthly cash-basis reconciliations. While they do not convert to accrual until the year-end financial statements, the hard part is cured because the accruals will be easy to obtain if all of the other pieces of information are available.

DISCUSSION: Governor Kempthorne asked Mr. Henry about his contract renewal. Mr. Henry stated this year is the firm's last year on an extended contract. Initially, Deloitte & Touche was retained on a three-

year basis. The contract was then extended through three one-year renewals. Next year, 2004, the Endowment audit will be up for proposals. Governor Kempthorne asked if the contract now automatically is subject to competitive bid. Mr. Henry stated that is correct. Governor Kempthorne asked about the process and if the EFIB makes the determination. Mr. Henry stated the EFIB does make the determination, as is typical with all government agencies. The typical bid range is three to five years. Governor Kempthorne asked if the bid would be submitted to the Land Board for final approval of the contract. Dr. Hallett responded that this process has changed with the EFIB's relationship with the Land Board. Rules are evolving. The EFIB's intention would be to bring a Request for Proposal to the Land Board. The EFIB has been very satisfied with Deloitte & Touche, but the time is right to go out with a proposal.

Mr. Henry. Mr. Henry reviewed the audit report with the Board. A report summary, provided by Mr. Henry, is shown below.

IDAHO STATE LAND BOARD
STATE OF IDAHO ENDOWMENT FUNDS
2002 AUDIT PRESENTATION
FEBRUARY 11, 2003

1. Department of Lands/Endowment Receipts Reconciliation
2. Auditors' Reports issued
 - A. Report on General Purpose Financial Statements—Unqualified
 - B. Report on Compliance and on Internal Control Over Financial Reporting Based Upon the Audit Performed In Accordance With *Government Auditing Standards*—No instances of non-compliance under *Government Auditing Standards* and no material weaknesses in internal control over financial reporting
 - C. Report on Examination of Management's Assertions—Exceptions noted
 - D. Comment and Recommendations Report to Management
3. Review of Findings and Recommendations
 - A. Implement accrual basis year end closing procedures – 2003 will be first test of new 13th period capability
 - B. Implement timely reconciliation process with Department of Lands --incorporated in new data entry and reconciling process
 - C. Correct inconsistencies in policy statements – completed
 - D. Fill empty Board position – implemented
 - E. Rebalance fixed income portfolio -- implemented

DISCUSSION: Governor Kempthorne asked if a one-page summary exists showing exceptions to the boiler-plate language. Mr. Henry stated currently no such page exists, but one could be created. Governor Kempthorne commented after witnessing current happenings with accounting firms and corporations, too often audits are nicely bound reports that are assumed to be static. We need very obvious flags. Governor Kempthorne recommended that future audit reports be presented to all principals involved as a group. Dr. Hallett agreed. He also agreed that a one-page summary showing exceptions and recommendations would be helpful, and he will request such a summary as part of the next audit report. Governor Kempthorne suggested calendaring the joint meeting when the next audit is complete. Dr. Hallett stated he would encourage Mr. Haertzen to develop a policy for the EFIB that will provide for a joint audit report presentation, along with guidelines for the EFIB when they go to proposal.

Governor Kempthorne asked what happens to the audit report in the respective offices. Controller Johnson stated his office reviews the report with respect to the State's audited financial statements. Mr.

Henry commented Darla Rankin of the Controller's staff probably spends more time reviewing the report in detail than any of the other offices.

Governor Kempthorne asked if any items should be on the Land Board's radar screen for the next audit report. Mr. Henry stated there are two areas to watch – reconciliation process and new internal controls. Due to the system change, there are new processes that need to be tested. The Endowment accountant is still working through the changeover process. He is getting comfortable with the new monthly reconciliations and the new sources that he looks to for answers. The system is working well.

Governor Kempthorne asked how the Land Board would monitor that changeover process so that six months from now the Land Board will know that the process has been strengthened as opposed to it ending up on the flagged list. Mr. Haertzen stated he is following those items very closely, and the Land Board should hold him accountable for any items on the report. Mr. Haertzen stated he expects a very clean report, and the report will be delivered to the Land Board in either August or September this year. Dr. Hallett added most recommendations in the report have been addressed. Two primary matters needing monitoring throughout the year are reconciliation and internal controls. The EFIB will expect regular reports from Mr. Haertzen.

Mr. Henry stated when the auditor finds a problem he sits down with the person responsible in that area and works to resolve the problem immediately. In most cases, the problem is resolved. Information regarding this process resides in the management document. Governor Kempthorne recommended that Mr. Haertzen convert this management document into a "to do" list in layman's terms so the Land Board will know what must be done during the next year. Mr. Haertzen stated he would make sure the information is pulled together and on the calendar for this fall.

Governor Kempthorne asked if it would be fair to say that the audit report presented today does not contain any significant flags. Mr. Henry stated there are no significant flags at this point. Dr. Hallett commented reconciliation has been a long-standing problem that one agency alone cannot solve. Now that the Endowment Fund is under the umbrella of the Land Board, matters will be easier to address.

Governor Kempthorne recommended a joint meeting of the involved parties six months before the completion of the audit report to allow a mid-year course correction discussion. Mr. Haertzen asked if there should be a preliminary starting meeting in March. Governor Kempthorne stated yes. Governor Kempthorne added he would also appreciate the Treasurer's input because of the role that office plays.

No action was taken on this agenda item.

8. Legislative Update – Presented by Winston Wiggins, Director, Idaho Department of Lands

Director Wiggins provided the background and status of bills monitored by the Department.

HB 0043 – Allows the State Board of Land Commissioners to increase the annual forest practices assessment for private owners of forest lands from five cents per acre to a maximum of ten cents per acre.

- Status – Pending in House Resources & Conservation Committee; anticipated hearing the week of February 10.

HB 0044 – Exempts commercial leases from the lease year of January 1 through December 31; exempts commercial leases of state lands from an expiration date on December 31 of the year of expiration.

- Status – Passed House; pending in Senate Resources & Environment Committee

HB 0046 – Allows the State Board of Land Commissioners to increase the annual fire preparedness assessment for private owners of forestlands from forty-five cents per acre to a maximum of sixty cents per acre.

- Status – Pending in House Resources & Conservation Committee; hearing scheduled February 11.

HB 0083 – Allows a 49-year lease on the property under lease to Tamarack (WestRock).

- Status – Passed House; pending in Senate Resources & Environment Committee

HB 0085 – Provides that either the Attorney General or the prosecuting attorney of the county can prosecute actions for the recovery of fire suppression costs incurred by the department.

- Status – Passed House; pending in Senate Judiciary Committee

HB 0090 – Supplemental appropriation for fire suppression.

- Status – Passed House and Senate; Governor's signature pending

HB 0110a – Creates a Pend Oreille Lake, Pend Oreille River, Priest Lake and Priest River Commission.

- Status – Pending in House State Affairs Committee

HB 0152 – Amends existing law to provide a procedure for a board of county commissioners to determine the status and regulation of a federally granted right-of-way.

- Status – Pending in House Transportation Committee

HJR 001 – Proposing an amendment to the Constitution making the State Treasurer a member of the State Board of Land Commissioners and providing that the Governor shall only vote only when the board is equally divided.

- Status – Pending in House State Affairs Committee

SB 1022 – Supplemental appropriation for tussock moth treatment.

- Status – Passed House and Senate; Governor's signature pending

SB 1056 – Reduces the minimum number of required meetings of the Board of Scaling Practices to two per year.

- Status – Pending in Senate Resources and Environment Committee

SJM 101 – Supports "Action Plan for Public Lands and Education"; Supports an initiative urging the federal government to provide an expedited land exchange process for land not intended for wilderness designation; supports seeking just compensation from the federal government for the impact its ownership of lands within the western states has on the ability of the states to fund public education.

- Status – Pending in House Education Committee

DISCUSSION: Governor Kempthorne asked if legislation is pending that would extend the two-year Land Bank to five years. Director Wiggins stated that legislation is not pending at this time. However, the Department will draft proposed legislation.

BOARD ACTION: A motion was made by Secretary of State Yursa to support legislation changing Idaho Code § 58-133 to reflect a five-year time period in which to use Land Bank funds instead of the current two-year time requirement. Attorney General Wasden seconded the motion. The motion carried on a vote

of 3-0, with Secretary of State Ysursa, Attorney General Wasden and State Controller Johnson voting aye; Governor Kempthorne recused himself from this vote; Dr. Howard was absent for this vote.

- A motion was made by Attorney General Wasden to resolve into Executive Session at 10:12 a.m. Secretary of State Ysursa seconded the motion. The motion carried on a vote of 4-0, with Superintendent Howard being absent for this vote.

- **EXECUTIVE SESSION**

A. To Consider and Advise Its Legal Representatives in Pending Litigation or Where There is a General Public Awareness of Probable Litigation [Idaho Code § 67-2345(1)(f)]

B. To Consider Personnel Matters [Idaho Code § 67-2345(1)(b)]

- A motion was made by Attorney General Wasden to resolve into Regular Session at 11:02 a.m. Secretary of State Ysursa seconded the motion. The motion carried on a vote of 4-0, with Superintendent Howard being absent for this vote.

There being no further business to come before the Board, the meeting adjourned at 11:02 a.m.

IDAHO STATE BOARD OF LAND COMMISSIONERS

/s/ Dirk Kempthorne

President, State Board of Land Commissioners and
Governor of the State of Idaho

/s/ Ben Ysursa

Ben Ysursa
Secretary of State

/s/ Winston A Wiggins

Winston A Wiggins
Director

The above-listed final minutes were approved by the State Board of Land Commissioners at the March 11, 2003 regular Land Board meeting.